Upstream Oil and Gas Equipment Market
PHILIPPINES
November, 2005

1. Market Overview and Outlook

Two major developments have triggered renewed interest in the upstream oil and gas industry in the Philippines: (1) the recent Supreme Court reversal of its previous ruling on foreign ownership restrictions on mineral resource extraction and (2) rising oil prices in the world market making exploration and other activities more economically and financially attractive compared to previous years.

Relative to other Southeast Asian countries notably Malaysia, Indonesia and Vietnam, oil and gas exploration and production activities in the Philippines have been limited in the past couple of years. Nonetheless, the country possesses promising areas for offshore exploration and production, most notably the areas surrounding the islands of Mindoro and Northwestern Palawan, the Visayan Sea and the Sulu Sea Basin. These areas have been found to have geologic characteristics similar to that of China and Indonesia, both of which have proven track records for the discovery of new oil deposits. However, these and other potential areas in the Philippines have been largely under-explored and their respective prospects remain untested.

In recent years, there has been renewed domestic interest in building the industry, particularly since the discovery of oil and gas reserves in the Malampaya offshore field in the 1990s. To take advantage of this growing interest, the Philippine Department of Energy (PDOE) has implemented a public contracting strategy to promote a more transparent and competitive process of encouraging investments into oil and gas exploration and development in pre-selected areas. To date, two Public Contracting Rounds (PCRs) have been conducted.

Industry insiders note that there is a growing interest in gaining access to existing reserves or undeveloped areas that were previously explored, but eventually discontinued due to lack of commercial viability at that time. They also see a trend towards cooperation between foreign principals (who previously shied away from the Philippines but are now re-establishing their local presence) and their local counterparts in exploring areas whose service contracts (SCs) are currently held by the former.

Meanwhile, new avenues for exploration activities are continuously opening up. For instance, small-scale operators have begun exploring marginal fields (i.e., areas with potential oil reserves of around one million barrels that were left unexplored by previous undertakings). Such activities are helping meet domestic energy requirements, particularly in alleviating power shortages in some areas.

In view of technological advancements, increasing crude oil prices, and ever-growing domestic demand for oil and gas, the Philippines is becoming an increasingly attractive site for gas and oil exploration and development. Another major discovery the likes of Malampaya oil field will provide the much-needed boost for the sector.

2. Market Sectors, Trends, Size, and Growth

a. Market Structure

Currently, the upstream oil and gas sector in the Philippines is composed of two groups of players. The first group consists of multinationals like the Dutch-based Shell Philippines Exploration B.V. (SPEX) and Premier Oil; British-owned Forum Exploration (formerly Sterling);

Japan Petroleum Exploration (JAPEX); BHP Billiton and Nido Petroleum from Australia; Malaysian oil company Petronas; U.S.-based Occidental, ChevronTexaco Malampaya and Unocal, as well as recent entrants like China National Offshore Oil Corporation (CNOOC) and Mitra of Indonesia. The second group is comprised of local companies led by the state-owned Philippine National Oil Company Exploration Corp. (PNOC-EC), Trans-Asia, Philodrill, Forum Exploration, Basic Petroleum, Alcorn, and Oriental Petroleum, among others. To secure Service Contracts (formerly known as Geophysical Survey & Exploration Contracts or GSECs) from the PDOE, members of the first group usually form a consortium with other companies belonging to their group and/or with one or more members of the second group.

As of October 2005, there were 20 active petroleum Service Contracts (SCs) being monitored by PDOE and operated by the different foreign and local players. SCs cover activities ranging from data acquisition and interpretation activities to gravity and seismic surveys and the drilling of appraisal wells, among others.

b. Oil and Gas Production and Development

Based on findings of the 2002 Philippine Petroleum Resource Assessment (PHILPRA), the Philippines has 16 sedimentary basins with a combined potential of 4,777 million barrels of fuel oil equivalent (BFOE). The PHILPRA study puts the oil, natural gas and condensate inventory at an estimated 9.0 trillion BFOE. In particular, PDOE reports that discovered petroleum reserves are estimated at 168 million barrels of oil, 3,841 billion cubic feet of gas and 109 million barrels of condensate. Meanwhile, petroleum resources classified as mapped yet undiscovered are placed at 1,341 million barrels of oil, 8,112 billion cubic feet of gas and 55 million barrels of condensate.

Prior to the first Public Contracting Round (PCR-1), only 10% of the country's petroleum reserves had been discovered, providing the impetus for further exploration opportunities.

Philippine oil and gas production has been marginal relative to other Southeast Asian countries. In 2004, 138,503 barrels (bbls) of oil were produced in Nido and Matinloc oil fields. During the same year, the areas of San Antonio, and for the largest part, Malampaya produced 87.56 billion cubic feet (bcf) of natural gas. Meanwhile, the Malampaya field produced 4.4 million barrels of condensate.

Under a Public Contracting Round (PCR) arrangement, DOE is offering a block referencing system for areas primed for petroleum exploration. The blocks are up for bids under public bidding system as opposed to a "first-come, first-served" strategy that was previously employed to award GSECs. The first round, PCR-1 launched in August 2003, offered 46 contract areas or blocks located mainly in the Palawan and Sulu Sea basins. A consortium led by Australian firm BHP Billiton was awarded service contract 41 (SC41) as a result of PCR-1.

The second round, launched in August 2005 and dubbed Philippine Energy Contracting Round (PECR), offered four petroleum contracts located in areas with proven reserves in Southwest Palawan, the Sulu Sea Basin and East Palawan. The deadline set by PDOE for submission of proposals for these areas and the lifting of moratorium has been set for November 29, 2005. Awarding of service contracts is expected from June 2006 onwards.

PDOE is projecting increased oil production from 2005 to 2010, following the expected reactivation of the Cadlao oil field, production from the Malampaya oil leg and the discovery of a new oil field within the next five years.

c. Threats and Challenges to Market Growth

Two interim challenges remain to market growth in the Philippines. These are: (1) limited areas discovered that have the same geologic configuration as the three priority areas previously cited (Mindoro and Palawan and the Sulu Sea Basin); and (2) a lack of adequate seismic data or technical information in some areas being primed for exploration.

3. Main Factors that will impact Offshore Equipment/Services Sales over the Next Few Years

Industry insiders agree that the most significant developments that have given a new lifeblood to the Philippine oil and gas sector have been the relaxing of foreign ownership restrictions on natural resource exploration and extraction and the current escalating trend in crude oil prices.

The government strongly supports developing the sector in order to reduce the country's dependence on imported fuel, as domestic demand continues to grow. (e.g., for power generation and transportation). This support will ultimately lead to increased investments in exploration-related activities and will trigger demand for offshore oil and gas equipment and services. The government's attractive incentive package and profit-sharing arrangements attest to its interest in stimulating growth in the sector.

Another major factor that will spur further growth in the local market will be the discovery of the next major oil reserve, similar to that of the Malampaya project. In fact, the areas surrounding the Malampaya rig are currently being explored by interested parties, with the hope that the next major find will lie somewhere nearby.

4. Regulatory Environment and Product Standards

Industry insiders note that the regulatory environment for oil and gas exploration has been relatively stable for the past couple of decades. Presidential Decree No. 87 also known as the Oil Exploration and Development Act of 1972 has provided the legal basis for exploration and development of indigenous petroleum resources in the Philippines and the awarding of service contracts to effect the same. Through the years, PD 87 has been complemented by a series of circulars issued by PDOE, which instituted the granting of incentives to oil and gas companies wishing to undertake exploration and development activities in the Philippines.

SCs awarded by DOE generally follow international standards and specifications. U.S. and other foreign companies can participate as operators and service contractors under such contracts. Current ownership rules (in accordance with the Philippine Constitution) allow for a maximum of 40% foreign equity participation in such business ventures.

Any resource extraction-related activity must also secure the necessary permits from the Philippine Department of Environment and Natural Resources (DENR), usually in the form of an Environmental Compliance Certificate (ECC), following an Environmental Impact Assessment (EIA) report. Likewise, to take advantage of government incentives, exploration and production ventures should be registered with the Philippine Board of Investments (BOI).

If state-owned companies such as PNOC-EC take the lead in procurement (i.e., if they have no less than 100% stake in a particular project), general government procurement guidelines are followed. Separate bidding and procurement processes exist for private sector players. The bidding process usually involves the issuance of a bid invitation, short listing of suppliers or service providers, review of technical specifications and bid offers, and finally awarding and execution of the contract. Typically, the standards and specifications follow those prescribed by

the American Petroleum Institute (API), American Bureau of Shipping (ABS) classification protocol and other similar international bodies.

5. Best Prospects for U.S. Companies

Generally, industry players have high regard and strong affinity for U.S. equipment and services. In fact, several U.S. products serve as the local industry's benchmark, particularly in terms of technical specifications.

Philippine-based buyers or Service Contract owners mainly source their major equipment and service requirements from suppliers in Singapore, which is largely considered a hub for oil and gas activities in the Southeast Asian region. For ancillary services (e.g., logistics, supply of manpower, repairs and servicing of platforms, documentation and liaison with regulatory bodies), the project owners usually rely on local contractors.

As in the global oil and gas exploration industry, U.S. companies such as Halliburton take the lead in securing "packaged" solutions (i.e., a comprehensive array of equipment and services sourced from different suppliers or service providers and offered as a package) from the multinationals. Halliburton faces serious competition from companies such as Schlumberger of France. Smaller players in the industry source equipment and services on an individual, "as needed" basis. Service contract owners and operators have the option to buy or lease, depending on the agreement with the supplier.

The following serve as major factors that impact the decision to purchase (in terms of priority) oil and gas exploration and production equipment:

1. Meeting technical specifications and availability when needed
2. Price
3. Safety considerations (compliance with health, safety and environmental standards)
4. Proximity of source and availability of after sales service and service equipment (there are instances where scheduling of the service equipment is done on a first come, first served basis, conflicting with exploration and production schedules)

U.S. companies are leading market players in both services provision and equipment supply. The majority of the service providers in geophysical (i.e., seismic, magnetic and gravity) surveys, drilling services, and geological consultants are from the U.S. or are affiliates of U.S.-based companies.

In terms of equipment, U.S. brands also figure prominently. Well head equipment, testing equipment (e.g., Baker Hughes); subsurface pumps (e.g., National Oilwell, Baker), mud equipment and accessories (Baroid, Swaco, Dril-Quip), and derricks and accessories are imported from the U.S., typically through local agents or from their regional representative offices in Singapore, Malaysia or elsewhere in the Southeast Asian region.

There is, however, significant competition from other countries such as the United Kingdom, France, Australia and recently India and China (although quality and safety issues exist with India and China, despite a huge price differential).

6. Recent Developments and Project Opportunities

The following recent developments have been identified by PDOE and various industry sources:

- Philodrill, a Philippine company, is currently negotiating to reach farm-out agreements with other oil and gas companies to reactivate Cadlao field off Palawan island.

- Forum Exploration (formerly known as Sterling Resources) is gearing up to develop the Libertad gas field, an onshore project in north Cebu island covered by SC 40. Feasibility studies have already been completed and are awaiting declaration of commerciality.

- Japan Exploration (JAPEX), which has been awarded SC46 is expected to drill an oil well in Cebu beginning June 2006.

- Between 2005 and 2012, several exploration wells are lined up for drilling by the different consortia owning their respective SCs. These include SC 43 (Premier Oil) in Ragay Gulf; SC 45 (South Sea Petroleum) located in the Agusan-Davao Basin; SC46 (JAPEX) in Tañon Strait; SC37 (Petronas Carigali and PNOC-EC) in Mindoro; SC48 (Aragon Power) in Cagayan Basin; SC 50 (Ottoman Energy) in Northwestern Palawan; and SC49 (Phil-Mal Petroenergy) in Southern Cebu.

- PNOC-EC, the state owned oil company, recently teamed up with China National Offshore Oil Company (CNOOC) and PetroVietnam for a Joint Marine Seismic Undertaking (JMSU) involving the acquisition of 11,000 km of 2D and 3D seismic data over 143,000 sq km of the South China Sea block. CNOOC has agreed to do the acquisition, PetroVietnam will take care of processing the data while PNOC-EC will be responsible for data interpretation.

U.S. companies interested in these and other leads should contact the U.S. Commercial Service in Manila (CS Manila) for possible assistance in exploring possible business opportunities. CS Manila can liaise with government and/or private sector contacts; assist in making appointments with local representatives or partners who can provide periodic updates on upcoming procurement and bid notices; and make direct representations with Service Contract owners, end-users or local contractors and with the Philippine DOE for further information and possible collaboration.

7. Tariff and Non-Tariff Barriers to Market Entry

Generally, there are no tariffs or duties imposed on imported exploration and production equipment if used for such purpose and if the equipment cannot be sourced locally. There are provisions in the Petroleum Production Sharing Contract or ancillary agreements regarding taxes levied on services rendered, but offshore oil and gas exploration, development and production are exempted from the 10% Value Added Tax (VAT) imposed on finished goods and services. Also, unlike other countries, there are no royalties imposed by the Philippine government on service contracts or production sharing agreements above and beyond the profit-sharing scheme.

8. Post's Contact Information

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